

# Employment protection legislation

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# Content of the lecture

- A description of employment protection in Italy and Europe
- A description of some economic consequences of employment protection

# Sources of information

## **Information and data on employment protection:**

Oecd detailed information on several countries

<http://www.oecd.org/els/emp/All.pdf>

# Reasons for employment protection

- Government should intervene in the working of the labour markets and promote employment protection:
  - To correct market failures that could be present in the labour market
  - Outside strictly economical reasons, there are also ethical and ideological reasons.

# Job protection legislation

- In general, employers do not have the right to freely dismiss their employees.
- In many countries *job protection legislation* imposes some conditions for the dismiss to be *fair*. *Unfair* dismissal are thus sanctioned.
- The sanction can takes the form of a *Monetary Compensation* or *Reinstatement*.

# The economics of job protection

- There is not a full "economic" (efficient) rationale for protecting employment.
- The only partial economic reason is that during recessions, job protection prevent employment level to quickly fall.
- Job protection causes inefficiency in the economy and in particular:
  - Firms cannot obtain their optimal employment.
  - Workers' effort is lower.
- However, job protection improves working conditions and it can be well worth to promote it.

# The economics of job protection

- To all extent in the presence of employment protection we observe that firms have to pay a certain cost  $z$  to fire workers.
- Therefore firing cost are actually an expected cost that increases the expected labour costs.
- This cost depends on the actual worker compensation and on the administrative costs of the process.
- In case of reinstatement the cost can be seen as equal infinity so that actual no firing will be put forth.
  
- Under perfect flexible wages, this cost is shifted to the workers so that unemployment may turn out to be unaffected.
  
- If wages are fixed (or bargained) the costs cannot be shifted on wages and therefore employment is likely to be effected.

# Job protection legislation in Italy

- Strong emphasis on fair/unfair dismissal
- It is fair to dismiss a worker only if there is a ***just cause*** or ***just motive***.
- Outside these cases, the dismissal is unfair



# Job protection legislation in Italy

- It is fair to dismiss a worker only if there is a ***just cause*** or ***just motive***.
- They are due to:
  - **Economic causes:** reorganization of the firm, reduction of employments, closing of some firms sector: in this case the actual work position is destroyed.
  - **Disciplinary cause:** relevant misbehaviors of workers like theft, violence, unjustified absences, contract violations.

# Italy: Recent reform and Jobs Act

- In Italy, legislation on employment protection has recently been changed: a new reform, called Jobs Act, has been introduced.
- In Italy, in cases of unfair dismissal:
  - ***Before the reform***: reinstatement was ordered
  - ***Jobs act*** (from 2015): a monetary compensation is ordered.

# Jobs act and the monetary compensation

- In case of firing a worker that believes to have been fired unfairly can ask a Judge to rule on the dismissal. If the dismissal is ruled unfair the workers receive a compensation.
- The compensation amounts to 2 month of wage for each year of work. This amount is taxed.
- In some very restricted cases, reinstatement is ordered. This happens if some discriminatory reason for dismissal is found.
- Judges still rule on fairness of dismissal.

# Conciliatory procedure

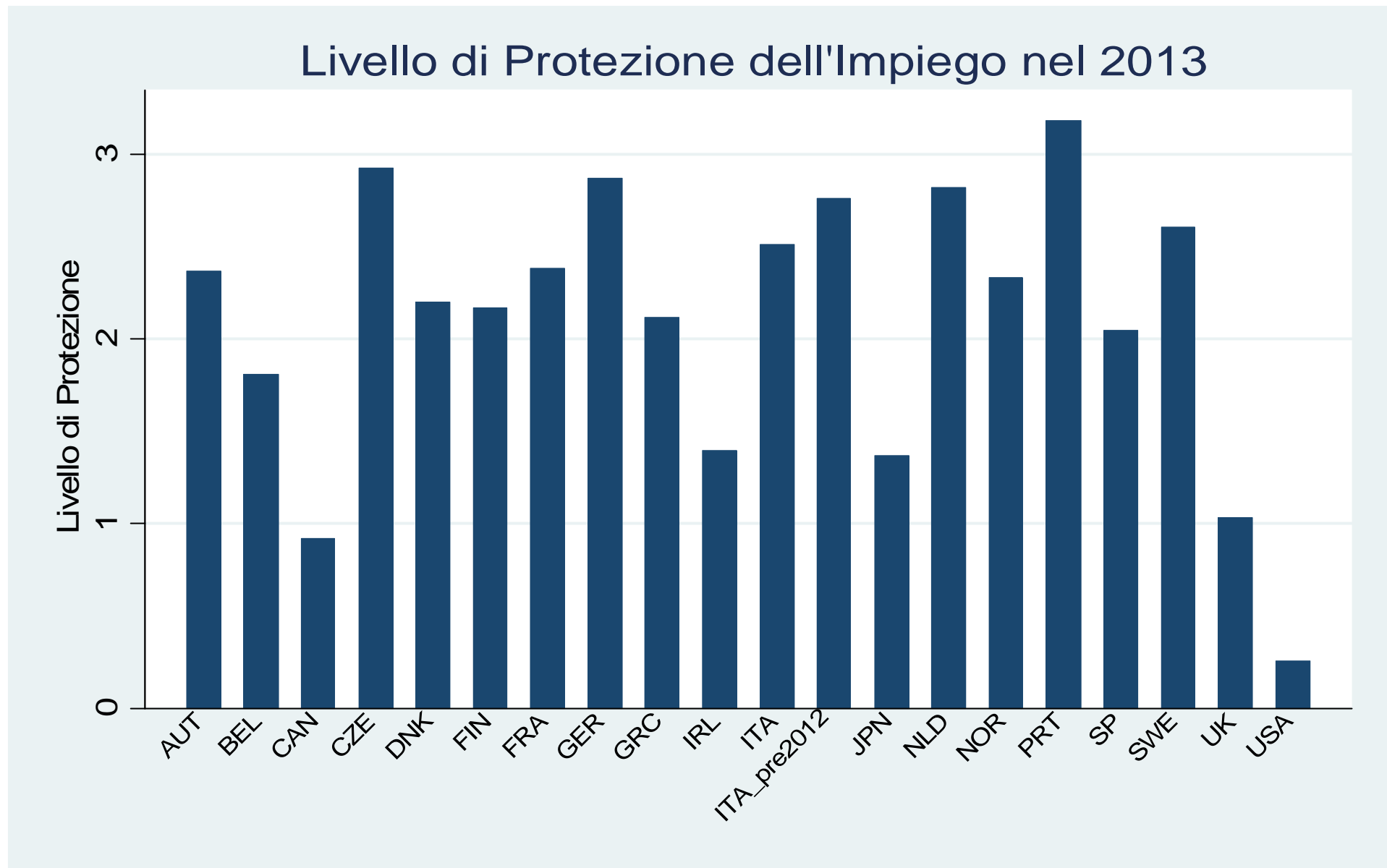
- In case of firing the worker and the firm can agree not to rule on fairness of dismissal and settle on compensation.
- In this case workers receive immediately and for certain a lower amount: 1 month of wage for each year of work.
- The government, to give incentive to this faster procedure, do not tax the compensation coming from this agreement.

# An European Comparison

- The concept of unfair dismissal is present in most of EU countries.
- The only countries where this concept is not fully applied are:
  - Greece, Hungary, UK (and US)
- However, in several EU countries, in case of unfair dismissal reinstatement is not compulsory and severance payment is instead paid. This happens in:
  - *Belgium, (Denmark), Estonia, Finland, France, (Germany), (Italy), Luxembourg, Slovenia, Spain, Sweden.*
- **Note:** all the above does not apply if the dismissal is ruled to be based on discrimination motives.

# Employment protection index

- OECD produces a synthetic index measuring employment protection



# Economic consequences of employment protection

- Employment protection can have consequences on

1) Total employment

2) Workers effort

3) Wages

4) Productivity

5) Welfare

# Employment protection and total employment

- When employment protection is large, firms hire less, because they know that if the economic situation get worse they will not be able to freely adjust employment. This would reduce total employment.
- However, in recessions, the presence of employment protection do not allow firms to freely fire workers and this slow down the reduction of employment.



# Employment protection and total employment

- The overall effect of employment protection on total employment is thus ambiguous.
- In anycase, in the presence of employment protection firms do not choose employment optimally and thus there is a loss of efficiency.

## Employment protection and effort

- In the absence of the "firing threat" workers could put less effort in their job or, at any rate, they could perform less than their full capabilities.
- Some theoretical analysis stress that in the presence of high employment protection workers find convenient to reduce their effort.
- Empirical analyses partly confirm this: in particular it has been shown that in the presence of strong employment protection workers are more absent from the workplace.

# Employment protection and wages

- Employment protection is, to all extents, a cost for firms. In fact firms cannot keep employment at its optimal level and/or have to pay some money when it adjust employment.
- For this reason, at least theoretically, firms can shift all or part of this cost to workers that will then receive a lower wage.

# Employment protection and productivity

- Economic theory stress several possible relationship between employment protection and productivity
- In some case, there is a negative relationship:
  - Employment protection force firms to mantain jobs and workers that are not particularly productive.
  - Workers hire less and "newer" worker have more problem in finding a job: this is a problem when there are relevant technological change.
  - Workers exert less effort.

# Employment protection and productivity

- In other cases the relationship is positive:
  - Given that firms are forced to "keep" hired workers, this gives an incentive to invest in them and to provide them with training and skills.
  - Workers that are protected can focus on long term activities rather than short term and this could increase productivity.

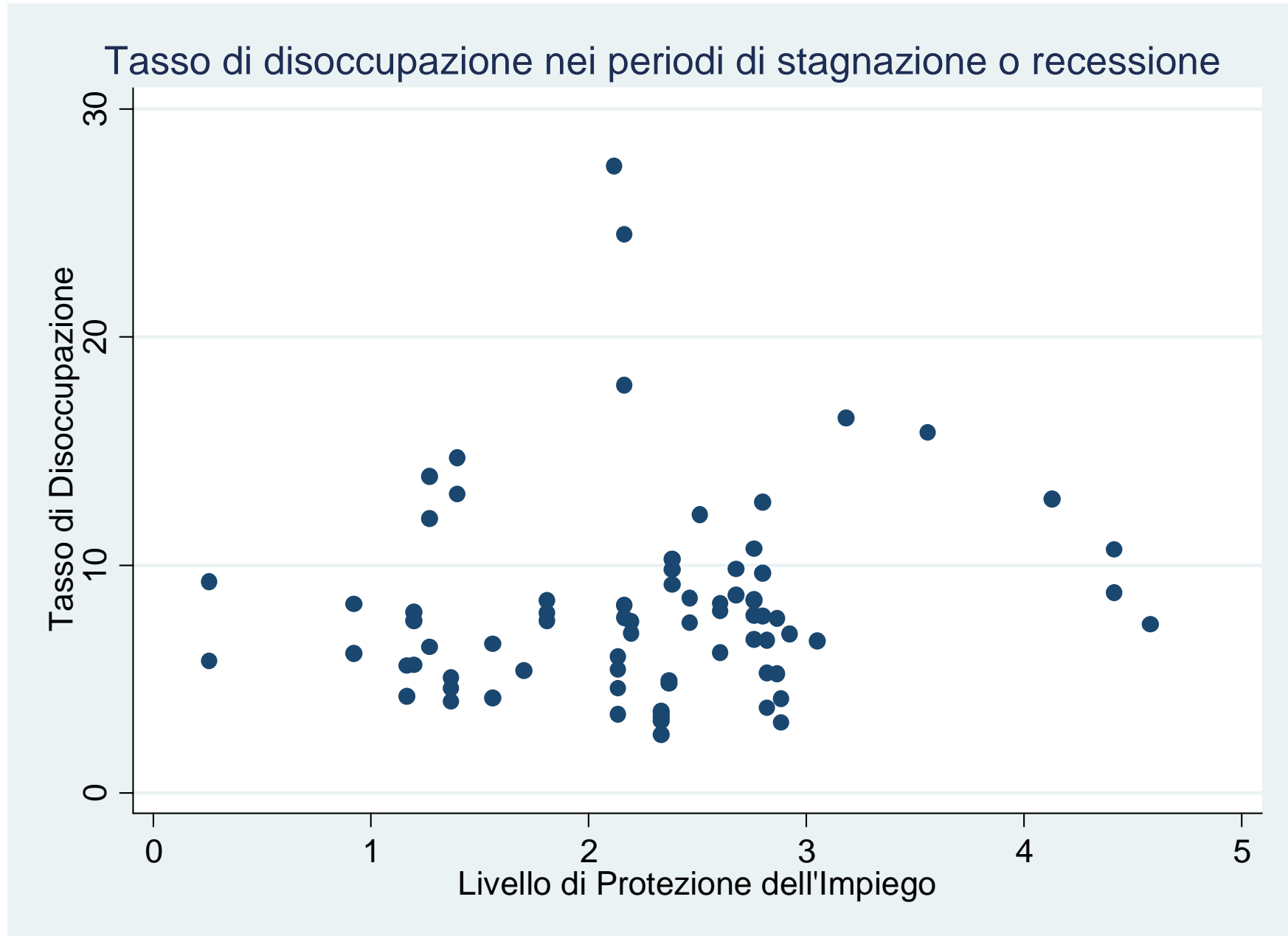
# Employment protection and productivity

- Empirical results are ambiguous, however:
  - From a subjective point of view, it has been shown that the more the firms are innovative, the more they "complain" about employment protection.
  - From an objective point of view, productivity is lower where there is a lot of employment protection and great variability of demand.

# Employment protection and welfare

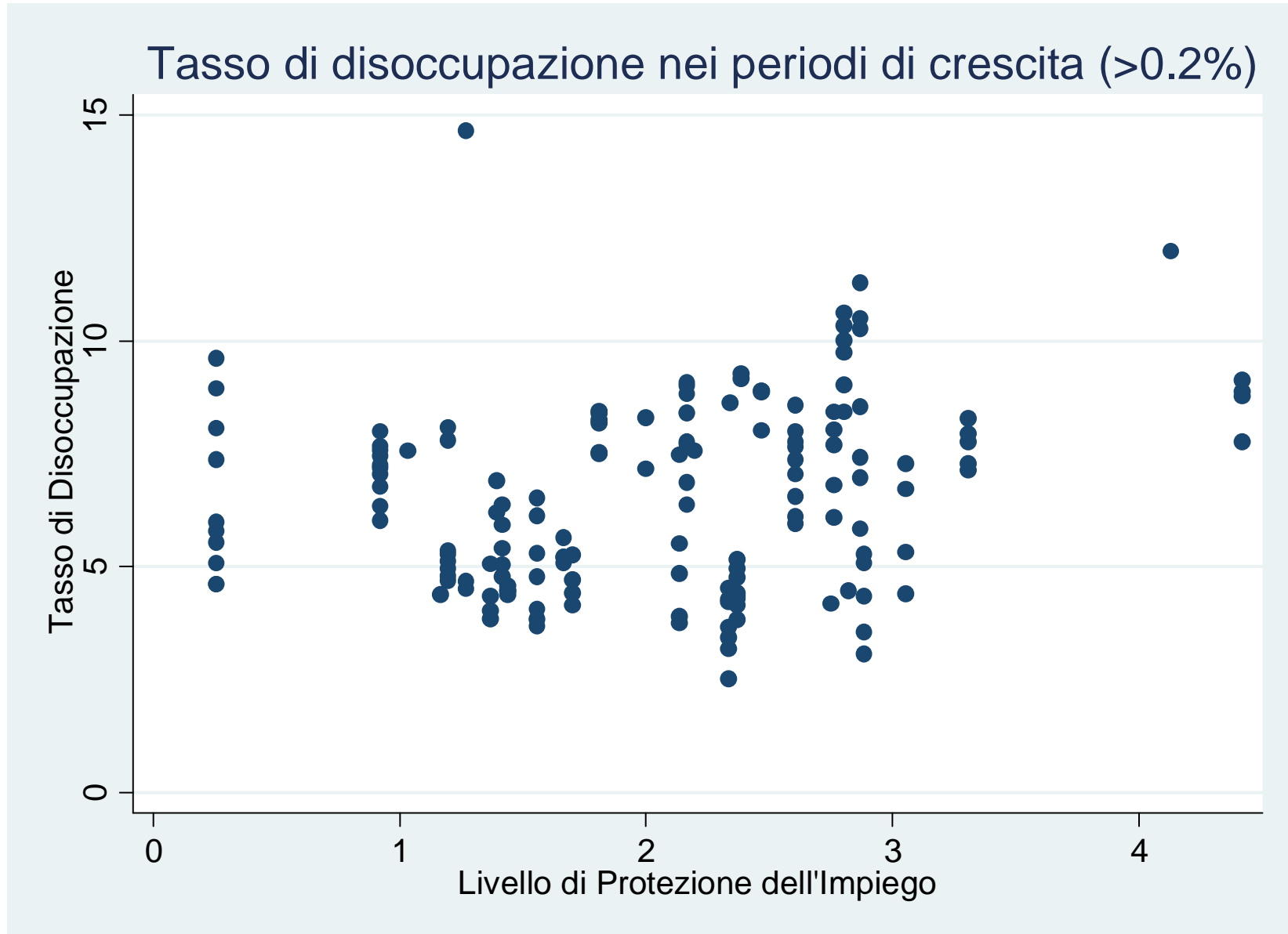
- In anycase, it is important to stress that in the presence of employment protection working conditions and life conditions of workers are better.
- The stability granted by employment protection allows worker to better plan their life and economic decisions.

# Unemployment rate and EPL in recession

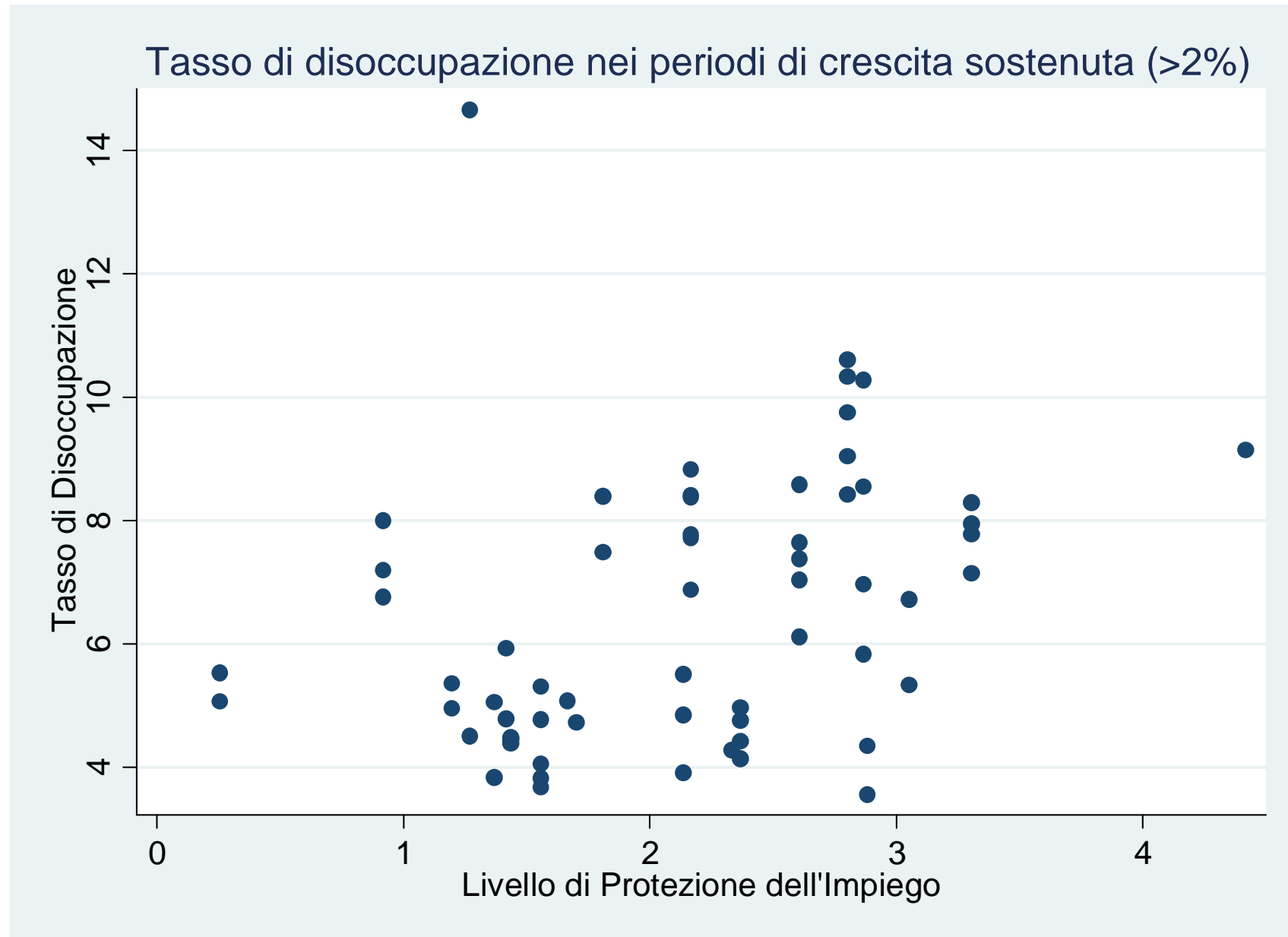




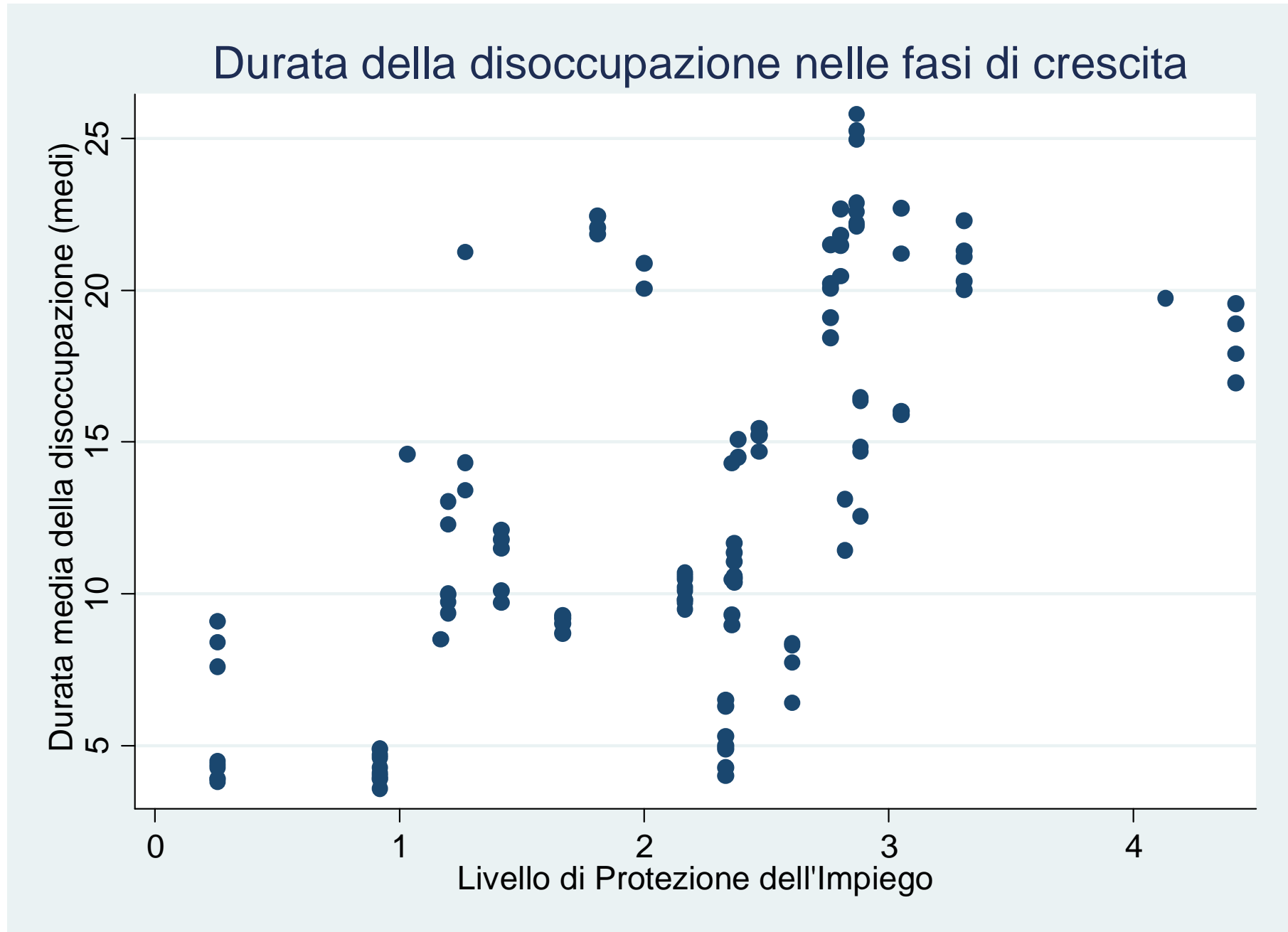
# Unemployment rate and EPL during mild growth



# Unemployment rate and EPL during strong growth



# Unemployment duration and EPL during growth



# Unemployment duration and EPL during recessions

